



FINANCIAL STABILITY OVERSIGHT COUNCIL

Analytic Framework for Financial Stability Risk Identification, Assessment, and Response

AGENCY: Financial Stability Oversight Council.

ACTION: Proposed analytic framework; request for public comment.

SUMMARY: The Financial Stability Oversight Council (Council) is proposing to adopt an analytic framework that describes the approach the Council expects to take in identifying, assessing, and responding to certain potential risks to U.S. financial stability.

DATES: Comment due date: [INSERT DATE THAT IS 60 DAYS AFTER PUBLICATION IN THE FEDERAL REGISTER]

ADDRESSES: You may submit comments by either of the following methods. All submissions must refer to the document title and RIN 4030-[XXXX].

Electronic Submission of Comments: You may submit comments electronically through the Federal eRulemaking Portal at <https://www.regulations.gov>. Electronic submission of comments allows the commenter maximum time to prepare and submit a comment, ensures timely receipt, and enables the Council to make them available to the public. Comments submitted electronically through the <https://www.regulations.gov> website can be viewed by other commenters and interested members of the public. Commenters should follow the instructions provided on that site to submit comments electronically.

Mail: Send comments to Financial Stability Oversight Council, Attn: Eric Froman, 1500 Pennsylvania Avenue NW, Room 2308, Washington, D.C. 20220.

All properly submitted comments will be available for inspection and downloading at <https://www.regulations.gov>.

In general, comments received, including attachments and other supporting materials, are part of the public record and are available to the public. Do not submit any information in your

comment or supporting materials that you consider confidential or inappropriate for public disclosure.

FOR FURTHER INFORMATION CONTACT: Eric Froman, Office of the General Counsel, Treasury, at (202) 622-1942; Devin Mauney, Office of the General Counsel, Treasury, at (202) 622-2537; or Carol Rodrigues, Office of the General Counsel, Treasury, at (202) 622-6127.

SUPPLEMENTARY INFORMATION:

I. Background

Section 111 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”) established the Financial Stability Oversight Council (Council), and section 112 sets forth its duties and purposes, which include identifying risks to U.S. financial stability and responding to emerging threats to the stability of the U.S. financial system.¹

The proposed Analytic Framework for Financial Stability Risk Identification, Assessment, and Response (Proposed Analytic Framework) describes the approach the Council expects to take in identifying, assessing, and responding to certain potential risks to U.S. financial stability. The Proposed Analytic Framework is not a binding rule,² and does not establish rights or obligations applicable to any person or entity, but is intended to help market participants, stakeholders, and other members of the public better understand how the Council expects to perform certain of its duties.

II. Questions for Public Comment

The Council seeks public comment on any aspect of the Proposed Analytic Framework, including the following questions:

¹ 12 U.S.C. 5321 & 5322.

² In a rule codified at 12 CFR 1310.3, the Council voluntarily committed that it would not amend or rescind certain interpretive guidance regarding nonbank financial company determinations set forth in Appendix A to 12 CFR part 1310 without providing the public with notice and an opportunity to comment in accordance with the procedures applicable to legislative rules under 5 U.S.C. 553. Section 1310.3 does not apply to the Council’s issuance of rules, guidance, procedures, or other documents that do not amend or rescind Appendix A, and accordingly, it does not apply to the Proposed Analytic Framework. Nonetheless, in the interest of transparency and accountability, the Council has chosen to publish its Proposed Analytic Framework and provide an opportunity for public comment.

1. Will the Proposed Analytic Framework enable the Council to achieve its statutory purposes and perform its statutory duties? Should the Proposed Analytic Framework address additional topics? Are there topics the Proposed Analytic Framework addresses but should not?

2. The Proposed Analytic Framework states that financial stability can be defined as the financial system being resilient to events or conditions that could impair its ability to support economic activity, such as by intermediating financial transactions, facilitating payments, allocating resources, and managing risks. Are there other definitions of “financial stability” the Council should consider?

3. The Council’s monitoring for potential risks to financial stability may cover an expansive range of asset classes, institutions, and activities, some of which are noted in the Proposed Analytic Framework. Are there asset classes, institutions, and activities not listed in the Proposed Analytic Framework the Council should monitor for potential risks to financial stability?

4. The Proposed Analytic Framework lists certain vulnerabilities that most commonly contribute to risk to financial stability: leverage; liquidity risk and maturity mismatch; interconnections; operational risks; complexity and opacity; inadequate risk management; concentration; and destabilizing activities. Are the Council’s descriptions of these vulnerabilities appropriate? Should the Proposed Analytic Framework address additional vulnerabilities?

5. The Proposed Analytic Framework also provides sample metrics associated with the listed vulnerabilities. Are the proposed sample metrics appropriate for the purposes described in the Proposed Analytic Framework? Are there additional sample metrics that the Proposed Analytic Framework should incorporate?

6. The Council has identified four channels as most likely to facilitate the transmission of the negative effects of a risk to financial stability: exposures; asset liquidation; critical function or service; and contagion. Do the transmission channels listed in the Proposed Analytic Framework capture the most likely ways in which the negative effects of a risk to financial

stability could be transmitted to other firms or markets? Should the Council consider additional transmission channels?

7. With respect to the vulnerabilities and transmission channels identified in the Proposed Analytic Framework, are there potential interactions between or among these vulnerabilities and transmission channels that the Proposed Analytic Framework should address?

III. Legal Authority

The Council has numerous authorities and tools under the Dodd-Frank Act to carry out its statutory purposes.³ As the agency charged by Congress with broad-ranging responsibilities under the Dodd-Frank Act, the Council has the inherent authority to promulgate interpretive guidance that explains the approach the Council expects to take in identifying, assessing, and responding to certain potential risks to U.S. financial stability.⁴ The Council also has authority to issue policy statements.⁵ The Proposed Analytic Framework describes how the Council intends to exercise its discretionary authority. The Proposed Analytic Framework does not have binding effect; does not impose duties on, or alter the rights or interests of, any person; and does not change the statutory conditions or standards for the Council's actions.

IV. Executive Orders 12866, 13563, 14094

Executive Orders 12866, 13563, and 14094 direct certain agencies to assess costs and benefits of available regulatory alternatives and, if regulation is necessary, to select regulatory approaches that maximize net benefits (including potential economic, environmental, public health and safety effects, distributive impacts, and equity). Pursuant to section 3(f) of Executive Order 12866, the Office of Information and Regulatory Affairs within the Office of Management

³ See, for example, Dodd-Frank Act sections 112(a)(2), 113, 115, 120, 804, 12 U.S.C. 5322(a)(2), 5323, 5325, 5330, 5463.

⁴ Courts have recognized that “an agency charged with a duty to enforce or administer a statute has inherent authority to issue interpretive rules informing the public of the procedures and standards it intends to apply in exercising its discretion.” See, for example, *Production Tool v. Employment & Training Administration*, 688 F.2d 1161, 1166 (7th Cir. 1982). The Supreme Court has acknowledged that “whether or not they enjoy any express delegation of authority on a particular question, agencies charged with applying a statute necessarily make all sorts of interpretive choices.” See *U.S. v. Mead*, 533 U.S. 218, 227 (2001).

⁵ See *Association of Flight Attendants-CWA, AFL-CIO v. Huerta*, 785 F.3d 710 (D.C. Cir. 2015).

and Budget has determined that the Proposed Analytic Framework is not a “significant regulatory action.”

FINANCIAL STABILITY OVERSIGHT COUNCIL

ANALYTIC FRAMEWORK FOR FINANCIAL STABILITY RISK IDENTIFICATION, ASSESSMENT, AND RESPONSE

I. Introduction

This document describes the approach the Financial Stability Oversight Council (Council) expects to take in identifying, assessing, and responding to certain potential risks to U.S. financial stability.

The Council’s practices set forth in this document are among the methods the Council uses to satisfy its statutory purposes: (1) to identify risks to U.S. financial stability that could arise from the material financial distress or failure, or ongoing activities, of large, interconnected bank holding companies or nonbank financial companies, or that could arise outside the financial services marketplace; (2) to promote market discipline, by eliminating expectations on the part of shareholders, creditors, and counterparties of such companies that the government will shield them from losses in the event of failure; and (3) to respond to emerging threats to the stability of the U.S. financial system.⁶ The Council’s specific statutory duties include monitoring the financial services marketplace in order to identify potential threats to U.S. financial stability and identifying gaps in regulation that could pose risks to U.S. financial stability, among others.⁷

Financial stability can be defined as the financial system being resilient to events or conditions that could impair its ability to support economic activity, such as by intermediating financial transactions, facilitating payments, allocating resources, and managing risks. Adverse events, or shocks, can arise from within the financial system or from external sources.

Vulnerabilities in the financial system can amplify the impact of a shock, potentially leading to

⁶ Dodd-Frank Act Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) section 112(a)(1), 12 U.S.C. 5322(a)(1).

⁷ Dodd-Frank Act section 112(a)(2), 12 U.S.C. 5322(a)(2).

substantial disruptions in the provision of financial services. The Council seeks to identify and respond to risks to financial stability that could impair the financial system's ability to perform its functions to a degree that could harm the economy. Risks to financial stability can arise from widely conducted activities or from the activities of individual entities, and from long-term vulnerabilities or from sources that are new or evolving.

This document describes the Council's analytic framework for identifying, assessing, and responding to potential risks to financial stability. The Council seeks to reduce the risk of a shock arising from within the financial system, to improve resilience against shocks that could affect the financial system, and to mitigate financial vulnerabilities that may increase risks to financial stability. The actions the Council may take depend on the nature of the vulnerability; for example, vulnerabilities originating from activities that may be widely conducted in a particular sector or market over which a regulator has adequate existing authority may be addressed through an activity-based or industry-wide response; in contrast, in cases where the financial system relies on the ongoing financial activities of a small number of entities, such that the impairment of one of the entities could threaten financial stability, or where a particular financial company's material financial distress or activities could pose a threat to financial stability, an entity-based action may be appropriate. The Council's authorities, some of which are described in section II.c, are complementary, and the Council may select one or more of those authorities to address a particular risk.

Among the many lessons of financial crises are that risks to financial stability can be diverse and build up over time, dislocations in financial markets and failures of financial companies can be sudden and unpredictable, and regulatory gaps can breed risk. The Council was created in the aftermath of the 2007-2009 financial crisis and is statutorily responsible for identifying and pre-emptively acting to address potential risks to financial stability. Many of the same factors, such as leverage, liquidity risk, and operational risk, regularly recur in different forms and under different conditions to generate risks to financial stability. At the same time, the

U.S. financial system is large, diverse, and continually evolving, so the Council’s analytic methodologies adapt to address evolving developments and risks.

This document is not a binding rule, but is intended to help market participants, stakeholders, and other members of the public better understand how the Council expects to perform certain of its duties. The Council may consider factors relevant to the assessment of a potential risk or threat to U.S. financial stability on a case-by-case basis, subject to applicable statutory requirements. The Council’s annual reports describe the Council’s work in implementing its responsibilities.

II. Identifying, Assessing, and Addressing Potential Risks to Financial Stability

a. Identifying Potential Risks

To enable the Council to identify potential risks to U.S. financial stability, the Council, in consultation with relevant U.S. and foreign financial regulatory agencies, monitors financial markets, entities, and market developments to identify potential risks to U.S. financial stability.

In light of the Council’s broad statutory mandate, the Council’s monitoring for potential risks to financial stability may cover an expansive range of asset classes, institutions, and activities, such as:

- markets for debt, loans, short-term funds, equity securities, commodities, digital assets, derivatives, and other institutional and consumer financial products and services;
- central counterparties and payment, clearing, and settlement activities;
- financial entities, including banking organizations, broker-dealers, asset managers, investment companies, insurance companies, mortgage originators and servicers, and specialty finance companies;
- new or evolving financial products and practices; and
- developments affecting the resiliency of the financial system, such as cybersecurity and climate-related financial risks.

Sectors and activities that may impact U.S. financial stability are often described in the Council’s annual reports. The Council reviews information such as historical data, research regarding the behavior of financial markets and financial market participants, and new developments that arise in evolving marketplaces. The Council relies on data, research, and analysis including information from Council member agencies, the Office of Financial Research, primary financial regulatory agencies, industry participants, and other sources.⁸

b. Assessing Potential Risks

The Council works with relevant financial regulatory agencies⁹ to evaluate potential risks to financial stability to determine whether they merit further review or action. The evaluation of any potential risk to financial stability will be highly fact-specific, but the Council has identified certain vulnerabilities that most commonly contribute to such risks. The Council has also identified certain sample quantitative metrics that are commonly used to measure these vulnerabilities, although the Council may assess each of these vulnerabilities using a variety of quantitative and qualitative factors. The following list is not exhaustive, but is indicative of the vulnerabilities and metrics the Council expects to consider.

- Leverage. Leverage can amplify risks by reducing market participants’ ability to satisfy their obligations and by increasing the potential for sudden liquidity strains. Leverage can arise from debt, derivatives, off-balance sheet obligations, and other arrangements. Leverage can arise broadly within a market or at a limited number of firms in a market. Metrics relevant for assessing leverage may include ratios of assets, risk-weighted assets, debt, derivatives liabilities or exposures, and off-balance sheet obligations to equity.

⁸ See Dodd-Frank Act section 112(d)(3), 12 U.S.C. 5322(d)(3).

⁹ References in this document to “relevant financial regulatory agencies” may encompass a broader range of regulators than those included in the statutory definition of “primary financial regulatory agency” under Dodd-Frank Act section 2(12), 12 U.S.C. 5301(12).

- Liquidity risk and maturity mismatch. A shortfall of sufficient liquidity to satisfy short-term needs, or reliance on short-term liabilities to finance longer-term assets, can subject market participants to rollover or refinancing risk. These risks may force entities to sell assets rapidly at stressed market prices, which can contribute to broader stresses. Relevant metrics may include the ratio of short-term debt to unencumbered short-term high-quality liquid assets, and amounts of funding available to meet unexpected reductions in available short-term funding.
- Interconnections. Direct or indirect financial interconnections, such as exposures of creditors, counterparties, investors, and borrowers, can increase the potential negative effect of dislocations or financial distress. Relevant metrics may include total assets, off-balance-sheet assets or liabilities, total debt, derivatives exposures, values of securities financing transactions, and the size of potential requirements to post margin or collateral. Metrics related to the concentration of holdings of a class of financial assets may also be relevant.
- Operational risks. Risks can arise from the impairment or failure of financial market infrastructures, processes, or systems, including due to cybersecurity vulnerabilities. Relevant metrics may include statistics on cybersecurity incidents or the scale of critical infrastructure.
- Complexity or opacity. A risk may be exacerbated if a market, activity, or firm is complex or opaque, such as if financial transactions occur outside of regulated sectors or if the structure and operations of market participants cannot readily be determined. In addition, risks may be aggravated by the complexity of the legal structure of market participants and their activities; unavailability of data due to lack of regulatory or public disclosure requirements and by obstacles to the rapid and orderly resolution of market participants. Factors that generally increase the risks associated with complexity or opacity may include a large size or scope of

activities, a complex legal or operational structure, activities or entities subject to the jurisdiction of multiple regulators, and complex funding structures. Relevant metrics may include the number of jurisdictions in which activities are conducted, and numbers of affiliates.

- Inadequate risk management. A risk may be exacerbated if it is conducted without effective risk-management practices, including the absence of appropriate regulatory authority and requirements. In contrast, existing regulatory requirements or market practices may reduce risks by, for example, limiting exposures or leverage, increasing capital and liquidity, enhancing risk-management practices, restricting excessive risk-taking, providing consolidated prudential regulation and supervision, or increasing regulatory or public transparency. Relevant metrics may include amounts of capital and liquidity.
- Concentration. A risk may be amplified if financial exposures or important services are highly concentrated in a small number of entities, creating a risk of widespread losses or the risk that the service could not be replaced in a timely manner at a similar price and volume if existing providers withdrew from the market. Relevant metrics may include market shares in segments of applicable financial markets.
- Destabilizing activities. Certain activities, by their nature, particularly those that are sizeable and interconnected with the financial system, can destabilize markets for particular types of financial instruments or impair financial institutions. This risk may arise even when those activities are intentional and permitted by applicable law, such as trading practices that substantially increase volatility in one or more financial markets, or activities that involve moral hazard or conflicts of interest that result in the creation and transmission of significant risks.

The vulnerabilities and metrics listed above identify risks that may arise from broadly conducted activities or from a small number of entities; they do not dictate the use of a specific authority by the Council. Risks to financial stability can arise from widely conducted activities or from a smaller number of entities, and the Council's evaluations and actions will depend on the nature of a vulnerability. While risks from individual entities may be assessed using these types of metrics, the Council also evaluates broader risks, such as by calculating these metrics on an aggregate basis within a particular financial sector. For example, in some cases, risks arising from widespread and substantial leverage in a particular market may be evaluated or addressed on a sector-wide basis, while in other cases risks from a single company whose leverage is outsized relative to other firms in its market may be considered for an entity-specific response.

In addition, in most cases the identification and assessment of a potential risk to financial stability involves consideration of multiple quantitative metrics and qualitative factors. Therefore, the Council uses metrics such as those cited above individually and in combination, as well as other factors, as appropriate, in its analyses.

The Council considers how the adverse effects of potential risks could be transmitted to financial markets or market participants and what impact the potential risk could have on the financial system. Such a transmission of risk can occur through various mechanisms, or channels. The Council has identified four transmission channels that are most likely to facilitate the transmission of the negative effects of a risk to financial stability. These transmission channels, which are non-exhaustive, are:

- Exposures. Direct and indirect exposures of creditors, counterparties, investors, and other market participants can result in losses in the event of a default or decreases in asset valuations. In particular, market participants' exposures to a particular financial instrument or asset class could impair those market participants if there is a default on or other reduction in the value of the instrument or assets. The potential threat to U.S. financial stability will generally

be greater if the amounts of exposures are larger; if transaction terms provide less protection for counterparties; if exposures are correlated, concentrated, or interconnected with other instruments or asset classes; or if significant counterparties include large financial institutions.

- Asset liquidation. A rapid liquidation of financial assets can pose a threat to U.S. financial stability when it causes a significant fall in asset prices that disrupts trading or funding in key markets or causes losses or funding problems for market participants holding those assets. Rapid liquidations can result from a deterioration in asset prices or market functioning that could pressure firms to sell their holdings of affected assets to maintain adequate capital and liquidity, which, in turn, could produce a cycle of asset sales that lead to further market disruptions. The potential risk is greater, for example, if leverage or reliance on short-term funding is higher, if assets are riskier and would experience a reduction in market liquidity in times of broader market stress, and if asset price volatility could lead to significant margin calls.
- Critical function or service. A risk to financial stability can arise if there could be a disruption of a critical function or service that is relied upon by market participants and for which there are no ready substitutes that could provide the function or service at a similar price and quantity. This channel is more prominent when the critical function or service is interconnected or large, when operations are opaque, when the function or service uses or relies on leverage to support its activities, or when risk management practices related to operational risks are not sufficient.
- Contagion. Even without direct or indirect exposures, contagion can arise from the perception of common vulnerabilities or exposures, such as business models or asset holdings that are similar or highly correlated. Such contagion can spread

stress quickly and unexpectedly, particularly in circumstances where there is limited transparency into investment risks, correlated markets, or greater operational risks. Contagion can also arise when there is a loss of confidence in financial instruments that are treated as substitutes for money. In these circumstances, market dislocations or fire sales may result in a loss of confidence in other financial market sectors or participants, propagating further market dislocations or fire sales.

The presence of any of the vulnerabilities listed above may increase the potential for risks to be transmitted to financial markets or market participants through these or other transmission channels. The Council may consider these vulnerabilities and transmission channels, as well as others that may be relevant, in identifying financial markets, activities, and nonbank financial companies that could pose risks to U.S. financial stability.

The Council may assess risks as they could arise in the context of a period of overall stress in the financial services industry and in a weak macroeconomic environment, with market developments such as increased counterparty defaults, decreased funding availability, and decreased asset prices, because in such a context, the risks may have a greater effect on U.S. financial stability.

The Council's work often includes efforts such as sharing data, research, and analysis among Council members and member agencies and their staffs; consulting with regulators and other experts regarding the scope of potential risks and factors that may mitigate those risks; and collaboratively developing analyses for consideration by the Council. As part of this work, the Council may also engage with market participants and other members of the public as it assesses potential risks. In its evaluations, the Council takes into account existing laws and regulations that have mitigated a potential risk to U.S. financial stability. The Council also takes into account the risk profiles and business models of market participants. Empirical data may not be

available regarding all potential risks. The type and scope of the Council's analysis will be based on the potential risk under consideration. In many cases, the Council provides information regarding its work in its annual reports.

c. Addressing Potential Risks

In light of the varying sources of risk described above (such as activities, entities, exogenous circumstances, and existing or emerging practices or conditions), the Council may take different approaches to respond to a risk, and may use multiple tools to mitigate a risk. These approaches may include acting to reduce the risk of a shock arising from within the financial system, to mitigate financial vulnerabilities that may increase risks to financial stability, or to improve the resilience of the financial system to shocks. The actions the Council takes may depend on the circumstances. When a potential risk to financial stability is identified, the Council's Deputies Committee will generally direct one or more of the Council's staff-level committees or working groups to consider potential policy approaches or actions the Council could take to assess and address the risk. Those committees and working groups may consider the utility of any of the Council's authorities to respond to risks to U.S. financial stability, including but not limited to those described below.

Interagency coordination and information sharing. In many cases, the Council works with the relevant financial regulatory agencies at the federal and state levels to seek the implementation of appropriate actions to ensure a potential risk is adequately addressed.¹⁰ If they have adequate authority, existing regulators could take actions to mitigate potential risks to U.S. financial stability identified by the Council. There may be different approaches existing regulators could take, based on their authorities and the urgency of the risk, such as enhancing their regulation or supervision of companies or markets under their jurisdiction; restricting or prohibiting the offering of a product; or requiring market participants to take additional risk-

¹⁰ See Dodd-Frank Act sections 112(a)(2)(A), (D), (E), (F).

management steps. If existing regulators can address a risk to financial stability in a sufficient and timely way, the Council generally encourages those regulators to do so.

Recommendations to agencies or Congress. The Council may also make formal public recommendations to primary financial regulatory agencies under section 120 of the Dodd-Frank Act. Under section 120, the Council may provide for more stringent regulation of a financial activity by issuing nonbinding recommendations to the primary financial regulatory agencies to apply new or heightened standards and safeguards for a financial activity or practice conducted by bank holding companies or nonbank financial companies under their jurisdiction.¹¹ In addition, in any case in which no primary financial regulatory agency exists for the markets or companies conducting financial activities or practices identified by the Council as posing risks, the Council can consider reporting to Congress on recommendations for legislation that would prevent such activities or practices from threatening U.S. financial stability.¹² The Council will make these recommendations only if it determines that the conduct, scope, nature, size, scale, concentration, or interconnectedness of the activity or practice could create or increase the risk of significant liquidity, credit, or other problems spreading among bank holding companies and nonbank financial companies, U.S. financial markets, or low-income, minority, or underserved communities.¹³ The new or heightened standards and safeguards for a financial activity or practice will take costs to long-term economic growth into account, and may include prescribing the conduct of the activity or practice in specific ways (such as by limiting its scope, or applying particular capital or risk management requirements to the conduct of the activity) or prohibiting the activity or practice.¹⁴ In its recommendations under section 120, the Council may suggest broad approaches to address the risks it has identified. When appropriate, the Council may make a more specific recommendation. Prior to issuing a recommendation under section 120, the

¹¹ Dodd-Frank Act section 120(a), 12 U.S.C. 5330(a).

¹² Dodd-Frank Act section 120(d)(3), 12 U.S.C. 5330(d)(3).

¹³ Dodd-Frank Act section 120(a), 12 U.S.C. 5330(a).

¹⁴ Dodd-Frank Act section 120(b)(2), 12 U.S.C. 5330(b)(2).

Council will consult with the relevant primary financial regulatory agency and provide notice to the public and opportunity for comment as required by section 120.¹⁵

Nonbank financial company determinations. In certain cases, the Council may evaluate one or more nonbank financial companies for an entity-specific determination under section 113 of the Dodd-Frank Act. Under section 113, the Council may determine, by a vote of not fewer than two-thirds of the voting members of the Council then serving, including an affirmative vote by the Chairperson of the Council, that a nonbank financial company will be supervised by the Federal Reserve Board and be subject to prudential standards if the Council determines that (1) material financial distress at the nonbank financial company could pose a threat to the financial stability of the United States or (2) the nature, scope, size, scale, concentration, interconnectedness, or mix of the activities of the nonbank financial company could pose a threat to the financial stability of the United States. The Council has issued a procedural rule and interpretive guidance regarding its process for considering a nonbank financial company for potential designation under section 113.¹⁶ The Dodd-Frank Act requires the Council to consider 10 specific considerations, such as the company's leverage, relationships with other significant financial companies, and existing regulation by primary financial regulatory agencies, when determining whether a nonbank financial company satisfies either of the determination standards.¹⁷ Due to the unique threat that each nonbank financial company could pose to U.S. financial stability and the nature of the inquiry required by the statutory considerations set forth in section 113, the Council expects that its evaluations of nonbank financial companies under section 113 will be firm-specific and may include an assessment of quantitative and qualitative

¹⁵ The Council also has authority to issue recommendations to the Board of Governors of the Federal Reserve System (Federal Reserve Board) regarding the establishment of prudential standards and reporting and disclosure requirements applicable to large bank holding companies and nonbank financial companies subject to Federal Reserve Board supervision (Dodd-Frank Act section 115, 12 U.S.C. 5325); recommendations to regulators, Congress, or firms in its annual reports (Dodd-Frank Act section 112(a)(2)(N), 12 U.S.C. 5322(a)(2)(N)); and other recommendations to Congress or Council member agencies (Dodd-Frank Act section 112(a)(2)(D), (F), 12 U.S.C. 5322(a)(2)(D), (F)).

¹⁶ See 12 CFR part 1310.

¹⁷ Dodd-Frank Act section 113(a)(2) and (b)(2), 12 U.S.C. 5323(a)(2) and (b)(2).

information that the Council deems relevant to a particular nonbank financial company. The factors described above are not exhaustive and may not apply to all nonbank financial companies under evaluation.

Payment, clearing, and settlement activity designations. The Council also has authority to designate certain payment, clearing, and settlement (PCS) activities “that the Council determines are, or are likely to become, systemically important” under Title VIII of the Dodd-Frank Act. PCS activities are defined as activities carried out by financial institutions to facilitate the completion of financial transactions such as funds transfers, securities contracts, futures, forwards, repurchase agreements, swaps, foreign exchange contracts, and financial derivatives. Under the Dodd-Frank Act, PCS activities may include (1) the calculation and communication of unsettled financial transactions between counterparties; (2) the netting of transactions; (3) provision and maintenance of trade, contract, or instrument information; (4) the management of risks and activities associated with continuing financial transactions; (5) transmittal and storage of payment instructions; (6) the movement of funds; (7) the final settlement of financial transactions; and (8) other similar functions that the Council may determine.¹⁸ Before designating a PCS activity, the Council must consult with certain regulatory agencies and must provide financial institutions with advanced notice of the proposed designation by Federal Register publication. A financial institution engaged in the PCS activity may request an opportunity for a written or, at the sole discretion of the Council, oral hearing before the Council to demonstrate that the proposed designation is not supported by substantial evidence. The Council may waive the notice and hearing requirements in certain emergency circumstances.¹⁹ Following any designation of a PCS activity, the appropriate federal regulator will establish risk-management standards governing the conduct of the activity by financial institutions.²⁰ The objectives and principles for these risk-management standards will be to

¹⁸ Dodd Frank Act section 803(7)(C), 12 U.S.C. 5462(7)(C).

¹⁹ Dodd Frank Act section 804(c), 12 U.S.C. 5463(c).

²⁰ Dodd Frank Act section 805(a), 12 U.S.C. 5464(a).

promote robust risk management, promote safety and soundness, reduce systemic risks, and support the stability of the broader financial system.²¹ The risk-management standards may address areas such as risk management policies and procedures, margin and collateral requirements, participant or counterparty default policies and procedures, the ability to complete timely clearing and settlement of financial transactions, and capital and financial resource requirements for designated financial market utilities, among other things.²²

Financial market utility designations. In addition, the Council has authority to designate financial market utilities (FMUs) that it determines are, or are likely to become, systemically important.²³ An FMU is defined as any person that manages or operates a multilateral system for the purpose of transferring, clearing, or settling payments, securities, or other financial transactions among financial institutions or between financial institutions and the person.²⁴ The Council has issued a procedural rule regarding its authority to designate FMUs.²⁵ In determining whether designation of a given FMU is warranted, the Council must consider (1) the aggregate monetary value of transactions processed by the FMU; (2) the FMU's aggregate exposure to its counterparties; (3) the relationship, interdependencies, or other interactions of the FMU with other FMUs or with PCS activities; (4) the effect of the FMU's failure or disruption on critical markets, financial institutions, or the broader financial system; and (5) any other factors that the Council deems appropriate.²⁶ Once designated as an FMU, the FMU is subject to the supervisory framework of Title VIII of the Dodd-Frank Act. Section 805(a)(1)(A) requires the Federal Reserve Board to prescribe risk-management standards governing the FMU's operations related to its PCS activities unless the FMU is a derivatives clearing organization or clearing agency.²⁷ Specifically, section 805(a)(2) grants the Commodity Futures Trading Commission or

²¹ Dodd Frank Act section 805(b), 12 U.S.C. 5464(b).

²² Dodd Frank Act section 805(c), 12 U.S.C. 5464(c).

²³ Dodd-Frank Act section 804(a)(1).

²⁴ Dodd Frank Act section 803(6)(A), 12 U.S.C. 5462(6)(A).

²⁵ 12 CFR part 1320.

²⁶ Dodd Frank Act section 804(a)(2), 12 U.S.C. 5463(a)(2). See also 12 CFR 1320.10.

²⁷ Dodd-Frank Act section 805(a)(1)(A), 12 U.S.C. 5464(a)(1).

the Securities and Exchange Commission, respectively, the authority to prescribe such risk-management standards for a designated FMU that is either a derivatives clearing organization registered under section 5b of the Commodity Exchange Act or a clearing agency registered under section 17A of the Securities Act of 1934.²⁸ Such standards are intended to promote robust risk management, promote safety and soundness, reduce systemic risks, and support the stability of the broader financial system. In addition, the Federal Reserve Board may authorize a Federal Reserve Bank to establish and maintain an account for a designated FMU or provide the designated FMU with access, in unusual or exigent circumstances, to the discount window.²⁹ A designated FMU is subject to annual examinations by the relevant federal supervisory agency.³⁰

Kayla Arslanian,

Executive Secretary.

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²⁸ Dodd-Frank Act section 805(a)(2), 12 U.S.C. 5464(a)(2).

²⁹ Dodd-Frank Act section 806(a)-(b), 12 U.S.C. 5465(a)-(b).

³⁰ Dodd-Frank Act section 807, 12 U.S.C. 5466.